

APPENDIX B-1

COST ALLOCATION AND COST POOLING

This document provides general guidance on cost allocation principles, methods of allocating costs, the use of cost pools and allocation of personnel services costs to ensure that Workforce Investment Act (WIA) costs are properly and equitably distributed to the benefiting cost objectives.

Allocability is one of the basic cost principles used in determining whether or not costs are allowable. Allocability is a measure of the extent to which a cost benefits the program in general and its cost objectives in particular. To the extent that a cost does not benefit the program, the cost cannot be charged to the program.

The total cost of a grant program is comprised of the allowable direct costs incident to its performance, plus the allocable portion of allowable indirect costs, less applicable credits. Direct costs are readily identified with and directly charged to a specific cost objective. Costs that are not readily chargeable to a final cost objective are often aggregated into intermediate cost objectives, usually called cost pools, and are periodically allocated to final cost objectives using an appropriate allocation methodology.

Cost pools can be established for any type of cost when it is beneficial or necessary to pool costs. All pooled costs must ultimately be allocated to the final cost objectives in proportion to the relative benefits received by each cost objective.

REQUIREMENTS FOR FINANCIAL MANAGEMENT SYSTEMS

Organizations are required to follow the cost principles written in the applicable OMB circular. These cost principles require, in general, that, to be allowable, a cost shall be necessary and reasonable for the proper and efficient administration of the program; be allocable to the program; and, except as provided in the case of governmental recipients/sub-recipients, not be a general expense required to carry out the overall responsibilities of the Governor or a governmental sub-recipient. For nonprofits, the cost principles are outlined in OMB Circular A-122; for educational institutions, A-21; and for State and local governments, A-87. For commercial organizations, the cost principles are found at 48 CFR Part 31.

Beyond the general guidance provided in the circulars, there is no universal rule for classifying certain costs as either direct or indirect under every accounting system. Costs are normally classified as direct or indirect based on their relationship to a particular cost objective. Generally, a direct cost can be traced to a particular cost objective, whereas an indirect cost is incurred for multiple cost objectives and is charged to an intermediate cost objective pending allocation. A cost may be direct with respect to some specific service or function, but indirect with respect to the grant or ultimate cost objective.

Direct costs are classified as direct, while indirect costs are classified as being either shared indirect costs, or general indirect costs, commonly referred to as administrative overhead or general and administrative costs.

TYPES OF COSTS

Direct Costs

Direct costs may be specifically identified with and assigned to a final cost objective, such as a WIA cost category. Direct costs are charged directly to a final cost objective and do not require any further allocation or breakdown by funding source or cost category.

Example: The salary cost of a staff person performing case management duties for only WIA participants is directly assignable to the cost category of Intake, Assessment, Eligibility Determination, and Case Management. It is fully chargeable to WIA because the case manager is serving only WIA participants.

Example: The staff person in the above example performed case management duties for both WIA participants and Welfare-to-Work (WtW) participants and documented the hours spent on each program on a time sheet. The salary costs would be a direct charge to WIA and a direct cost to WtW based on the documented time sheet hours.

Indirect Costs

Indirect costs are costs incurred for a common or joint purpose benefiting more than one cost objective. These costs are not readily assignable to the cost objectives specifically benefited without effort disproportionate to the results achieved. This guide groups indirect costs into two categories for purposes of discussing cost pooling and cost allocation. These costs are shared indirect costs and general indirect costs. Each of these types of indirect costs is defined below and an example of each type is provided.

- ***Shared Indirect Costs***

Shared indirect costs are costs that cannot be readily assigned to a final cost objective, but which are directly charged to an intermediate cost objective or cost pool and subsequently allocated to final cost objectives. These costs are incurred for a common or joint purpose benefiting more than one cost objective. These costs are similar to the general indirect costs in that it is easier to assign or allocate them based on some measure of benefit received than to assign them directly to final cost objectives.

Example: Three staff members provide case management services to participants in the WIA program without regard to eligibility and it is difficult to identify time spent by participant. The case managers' costs are directly assigned to the cost category of Intake, Assessment, Eligibility Determination, and Case Management, but are not readily assignable by type of participant. The case managers' costs could be directly charged to a cost pool established to accumulate such costs and later distributed to the appropriate category using an appropriate allocation method, such as the relative number of participants enrolled.

- ***General Indirect (Overhead/G&A) Costs***

These costs may originate in the recipient's or sub-recipient's own organization or in other departments that supply goods, services, and facilities to the WIA program. Most often, however, indirect costs are administrative costs that are incurred to support the overall operation of the organization, and for which a direct relationship to WIA cannot be shown without effort disproportionate to the results achieved. Indirect costs are charged back to WIA using an indirect cost plan or rate. The development of indirect cost plans is contained in Attachments C and E of OMB Circular A-87 and Attachment A of OMB Circular A-122.

Example: The grantee is a department within the city, and the city treasurer processes WIA and other department vouchers for payment. Staff in the treasurer's office cannot readily identify the time and other costs associated with processing WIA vouchers. Rather, the city's approved indirect cost plan is used to charge WIA its share of the processing costs at least quarterly, using transaction counts as the basis for allocation.

MEASURING BENEFIT

Measuring benefit is the critical requirement and central task to be performed in allocating costs. Throughout this chapter the requirement is stressed that costs are allocable to a particular cost objective to the extent of benefits received by that cost objective. Likewise, costs that do not benefit a particular cost objective are not allocable to and cannot be charged to that cost objective. For a direct cost to be assignable to a particular cost objective, it is clear that the cost objective must receive the full benefit from the goods, services, activities, or effort that make up that cost. In this instance, measuring benefit entails no more than identifying the full cost of the activity and assigning it to the correct cost objective.

Example: The staff costs associated with performing WIA intake functions are directly assignable to the cost category of Intake, Assessment, Eligibility Determination, and Case Management. That cost objective receives the full benefit of the cost of the intake activity. Very often, however, a cost benefits more than one cost objective, so that any single cost objective receives only partial benefit from the cost incurred. Thus, the relative benefit received by each cost objective must be measured.

Example: If the intake staff in the above example also performed duties related to data collection at the same time, the costs would benefit more than one cost category and, therefore, must be prorated among the benefiting cost categories.

To determine each category's share of the cost, an allocation method must be identified that measures each category's share of the total benefit. It is possible and preferable in some cases to directly assign the correct portion of shared costs to each cost objective. For example, the intake staff in the above example could record the time spent performing each function and distribute the costs accordingly. However, it may require disproportionate effort to directly assign each segment of the total cost to the benefiting cost objective. When the direct measurement of benefit cannot be done efficiently and effectively, then it is appropriate to pool the costs for later

distribution. The allocation base is the mechanism used to allocate the pooled costs to final cost objectives and is discussed later in this chapter. Using the above example on intake staff costs, instead of staff recording time spent by activity, the organization could use the relative number enrolled by program or some other equitable basis for measuring benefit to each program.

Care should be taken to ensure that the basis chosen does not distort the results and that the basis is appropriate to the cost objectives receiving the costs. For pooled costs, the cost elements that make up the pool must be scrutinized to ensure that all costs are allowable. Costs that are not allowable must be removed from the pool before the pooled costs are allocated to WIA cost objectives.

Consistent Treatment

For a cost to be allocable to a particular cost objective, it must be treated consistently with other costs incurred for the same purpose in like circumstances. A cost may not be assigned to an award as a direct cost if any other cost incurred for the same purpose, in like circumstances, has been allocated to an award as an indirect cost. Costs identified specifically with awards are direct costs of the awards and are to be assigned accordingly. Costs identified specifically with other final cost objectives of the organization are direct costs of those cost objectives and are not to be assigned to other awards directly or indirectly.

Any cost allocable to a particular grant or other cost objective under these principles may not be shifted to other Federal grants to overcome funding deficiencies, to avoid restrictions imposed by law or grant agreement, or for other reasons. [OMB Circular A-87]

COST POOLS

Many types of cost pools are acceptable if established and managed properly in the entity's accounting system. Consider the following when developing cost pools:

- ***Written Cost Allocation Plan (CAP)***

The cost pool should be described and documented in a written CAP that is used in allocating all allocable direct costs within a program to the appropriate program activity and cost category. CAPs are further described in Appendix B-2.

- ***Combined Administrative Costs***

Shared indirect administrative costs can be combined with any general indirect administrative costs and allocated using an appropriate allocation methodology or base.

- ***Personnel Services***

Personnel services costs (salary and fringe benefits) of internal staff who spend a portion of their time in administrative and a portion of their time in allowable participant services functions can be individually distributed among the respective cost categories using staff

time records or other verifiable means. A supporting time record that prorates the time between two or more functions is recommended. Time records should include hours spent on each cost objective. A position description alone is insufficient documentation.

- ***Nonpersonnel Services***

Nonpersonnel service costs that benefit more than one cost objective can be allocated to more than one cost objective. Such allocations must be based on an appropriate allocation methodology.

Caution: Costs that may be pooled are limited to shared indirect and general indirect costs. Direct costs should not be pooled, but rather should be directly charged to the benefiting cost objective. Only actual, not budgeted, costs may be pooled and distributed to the various funding titles. Costs incurred based on an indirect cost rate may be included in the appropriate administrative cost pools for allocation. The allocation of cost pools based on benefits received should not be burdensome once the methodology is developed. Where a cost pool is used, the expenditures must be distributed among the various funding sources for reporting purposes. The method of allocation should be consistent with the guidelines addressed in other sections of this guide.

Types of Pools

- ***Administrative Cost Pools***

One of the benefits of an administrative cost pool is that very often administrative costs benefit multiple programs and the effort of directly classifying portions of a cost to a number of programs is onerous. However, care should be taken that the allocation methodology chosen fairly distributes the costs to all affected funding sources. The allocation of administrative costs or any other pooled costs based on fund availability or percentage of funding source administrative dollars (contribution method) is generally not allowable. The allocation of pooled administrative costs based on each program's share of direct costs is the best method.

- ***Other Cost Pools***

Additional cost pools can be established for any types of common costs when it is more practical or necessary to pool such costs.

Example: A local area grantee has frontline intake staff that conduct the initial intake for the WIA and other programs. An intake manager is responsible for overseeing and managing the client flow process, supervising the intake workers and reporting to the deputy director. All costs are initially pooled and charged, temporarily, to an intake related cost pool account. These costs include the salary and fringe benefits of the line staff and the intake manager, materials, phones, and other related costs required to carry out the intake function. Then, based on an approved formula that distributes costs based on benefits received by each program (such as the number of eligibility determinations

completed for each program or the number of persons enrolled during the period), the costs are charged back to the appropriate programs.

Cost Pool Management

Cost pools reduce some of the burden of tracking expenditures because they foster the temporary accumulation of unassigned direct and indirect costs that later will be allocated to a particular program. As costs accrue, a formula based on the benefits received by each program dictates how these costs will be distributed and reported by program title/subtitle or cost category.

ALLOCATING PERSONNEL SERVICES COSTS

Amounts charged to WIA programs for personnel services, whether direct or indirect costs, are most efficiently done if based on payrolls documented and approved in accordance with the established practice of the employing entity. Payrolls should be supported by time and attendance or equivalent records for individual employees. In general, time distribution records or other verifiable means will be used to document how personnel services costs are charged to cost objectives. Time sheets and/or time and attendance records alone, however, do not necessarily satisfy the time distribution requirements.

Daily Time Distribution Records

A time distribution system is a formal method for accumulating labor costs associated with specific programs. Time distribution can be documented in a variety of ways. The most commonly accepted method is to record actual time spent on each cost objective during each working day.

- ***Direct Costs***

When the personnel services cost of an individual is chargeable in full to a single cost objective, it is not necessary to maintain a daily time distribution record for that staff person. There should be other documentation available to support the claim that the person's activities and costs do not need to be allocated to more than one cost objective. Other documentation could include negative time distribution reporting, approved and written office policies and procedures or other written forms of task assignment.

- ***Shared Indirect Costs***

Salaries and wages of many employees are chargeable to more than one grant or cost category. Daily time distribution records, or some acceptable method of time sampling, are the most common forms of documentation used. The method used must accurately reflect the actual time spent on each activity by each employee. Budget estimates or other distributions determined before the services are performed cannot be used to support charges to a partner program.

For staff that maintain daily time distribution records, there are periods within the pay period when it is difficult to associate time worked with a specific cost objective. This is the case when a person is attending a general staff meeting or is on leave. It is

recommended that direct hours charged to each cost objective be used as the basis for allocating the other time that is spent on general activities, provided that there are a sufficient number of direct hours to establish an adequate base.

Nonpersonnel Services Costs

Nonpersonnel services costs, when directly associated with time worked by the recipient's or sub-recipient's staff, may also be allocated to the benefiting cost objectives based on documented distributions of actual time worked. These costs could include costs for space, utilities, building maintenance, supplies and others. To use time distribution as the basis for allocation of nonpersonnel services cost, time worked must be an equitable measure of the benefit derived from nonpersonnel services costs.

Example: Desktop supplies are stored centrally and used by all staff in performing their jobs. It is reasonable to conclude that the supplies are used in the same manner and for the same purpose as the time spent by staff while using the supplies. It is acceptable to use time distribution as the basis for allocating the cost of desktop supplies to various cost categories.

ALLOCATION BASES

When costs are pooled instead of being directly assigned to a final cost objective, the ability to directly assign benefit for each item of cost is lost. Instead, the pool contains a group of common costs to be allocated by using an indirect or approximate measure of benefit. The approximate measure of benefit is the allocation base.

An allocation base is the method of documentation used to measure the extent of benefits received when allocating joint costs among multiple cost objectives. Many different types of bases can be used in allocating costs. The basis used to allocate a particular type of cost should be used consistently over time and be described in the CAP.

Acceptable Allocation Bases

An allocation base is acceptable if it represents a fair measure of cost generation or cost benefit and if it results in an equitable distribution of the costs of services rendered or goods provided. General criteria that should be used in selecting an allocation base include the following:

- ***Minimal Distortion***

The base should distribute costs in a fair and equitable manner without distorting the results. This requires that the base be as causally related as possible to the types of costs being allocated so that benefit can be measured as accurately as possible. By contrast, it is much less appropriate to use post-employment services costs as the basis for allocating pooled intake costs since there is a very limited relationship, and no causal relationship, between the base and the type of costs in the pool. The results are likely to be distorted when using this base for allocating this type of costs.

- ***General Acceptability***

The base should be generally accepted. For example, it should be consistently applied over time. The base should also be drawn from the same period in which the costs to be allocated have been incurred. It is not appropriate to change the base for allocating pooled administrative costs from quarter to quarter, such as using direct program expenditures in the first quarter, number of participants served in the second quarter, and time distribution in the third quarter. It is also not appropriate to use last year's participant data as the basis for allocating this year's expenditures.

- ***Represents Actual Cost or Effort Expended***

The base should be a measure of actual cost or actual effort expended. It should not be based solely on a plan, budget, job description, or other estimates of planned activity. It is generally not appropriate to use the relative amount of funds required to be spent as the basis for allocating this pool of costs since budgets are not a measure of actual activity or effort.

- ***Timely Management Control***

The base should be within management's ability to control on a timely basis. The base should produce reliable and fairly predictable results. If the base is erratic and unpredictable, beyond management's ability to control, or not timely, it is likely to produce unacceptable results. It would be better for the organization to use a base that is within the direct control of the organization's management.

- ***Consistency with Variations in Funding***

The base must be able to accommodate and withstand changes in funding during the year and from year to year. If the base excludes factors that are affected by variations in funding, it will produce distorted results. It is not appropriate to allocate costs using a basis that does not include all funding received during the year. If an organization operates a State funded summer work experience program, then the basis for allocating case management costs would need to reflect changes in the mix of activities during the summer period or the distribution of costs may not be equitable.

- ***Materiality of Costs Involved***

The complexity of the base should be commensurate with the materiality of the costs to be allocated. In other words, the grantee should not spend more on obtaining the information needed to allocate pooled costs than the dollars in the pool warrant. The base should be sufficiently detailed to provide the most equitable and accurate allocation possible, yet, simple enough to be efficient while still attaining a fair distribution of costs.

- ***Practicality and Cost of Using the Base***

The base should be as efficient as possible in terms of the cost or effort in developing it. Thus, wherever possible, a database that already exists in the financial or participant

record keeping and reporting systems should be used rather than create a separate database to be used only for allocating costs. For example, it is more efficient to allocate participant transportation costs using current enrollment data that is already available, rather than creating a separate database on the exact number of participants receiving transportation assistance by type of participant.

Suggested Bases for Allocation

Some suggested bases for allocation are listed below. These are suggested bases only and grantees are cautioned to review these bases for applicability to their programs.

- Accounting —Number of transactions; direct labor hours; allowable survey methods
- Auditing —Direct audit hours; expenditures audited
- Budgeting —Direct labor hours
- Consumable supplies —Total direct costs; direct labor hours
- Counselor —Direct labor hours; number of participants counseled
- Data processing —System usage; direct labor hours
- Disbursing service —Number of checks issued; direct labor hours
- Fidelity bond —Number of bonded employees
- Freight —Number of items shipped; cost of goods
- Health services —Number of employees
- Intake —Number of eligibles; current period enrollments
- Legal services —Direct hours
- Motor pool costs —Miles driven; days used
- Office machines and —Direct machine hours; direct labor hours equipment maintenance
- Office space —Square feet of space occupied; staff salary distribution
- Payroll services —Number of employees
- Personnel services —Number of employees
- Postage —Direct usage; acceptable survey methods
- Printing/reproduction —Direct labor hours; job basis; pages printed
- Procurement service —Number of transactions processed; direct hours of purchasing agent's time
- Retirement system —Payroll; number of employees contributing administration
- Telephone —Number of instruments; staff salary distribution
- Travel —Mileage; Actual expenses; Direct labor hours
- Utilities —Square feet of space occupied; Staff salary distribution

Bases developed from plans, budgets, or estimates usually cannot stand on their own as valid measures of benefit. They can be used only in very limited situations, especially when the results can be corroborated by, or later adjusted for, the results obtained by using an acceptable base. This requires that the base be verified as able to produce an equitable distribution of costs.

Unacceptable Allocation Bases

In general, unacceptable allocation bases are those that do not meet the general guidelines discussed above. Unacceptable bases are those that:

- Distort the final results
- Do not represent actual effort or actual expenditures
- Are not used consistently over time and with variations in funding
- Do not have an integral relationship to the types of costs being allocated. Some commonly used bases that fall into this unacceptable category include the use of:
 - Relative funds available to allocate unassigned direct costs
 - Job descriptions to allocate staff costs
 - Fixed or predetermined number of staff hours assigned to an activity to allocate staff costs
 - Planned participant levels to allocate participant-related costs
 - Results from prior periods to allocate current period costs.

Bases developed from plans, budgets, or estimates usually cannot stand on their own as valid measures of benefit. They can be used only in very limited situations, especially when the results can be corroborated by, or later adjusted for, the results obtained by using an acceptable base. This requires that the base be verified as able to produce an equitable distribution of costs.

Example: The State and the WIA program fund a work experience program, jointly. Each funding source plans to provide 10 participants. Start-up costs are incurred and billed to the funding sources before all participants are enrolled. It is appropriate to use planned activity levels as the basis for allocating these costs since full enrollment by both funding sources is expected. However, any deviation from the plan must later be adjusted using actual enrollment data.

Common Errors

A common error in choosing a base is to use a plan, budget, or other estimate of future effort or cost. In most circumstances, this type of base is not acceptable because it does not measure actual activity, effort, or cost, and too often, later adjustments based on actual data are not made. In most instances, the most reliable measure of the amount of the cost incurred, the effort expended, and the benefit received can occur *only* when the activity is actually performed. Some grantees estimate (in their position descriptions, organizational charts, or other documents) the percentage of time their director or other staff members will be involved in the WIA program.

This estimate is useful for planning purposes but must eventually be supported by documentation of actual involvement in the WIA program. Costs charged to the program based on the estimates will need to be adjusted to reflect actual time spent on WIA activities. It is also common for grantees to determine the percentage of time their staff will be involved in the WIA and other programs. Occasionally, this determination results in pre-assigned number of hours available for WIA activities. Staff are instructed to charge WIA and other programs according to the established hours. Again, this predetermination is useful for budget purposes; however, any costs charged to the WIA program must be adjusted as necessary to reflect actual time spent on benefiting WIA activities.

We repeat the standard caution that a particular basis may work in some circumstances and not in others, and that the ultimate test of appropriateness is whether or not the basis used results in an equitable distribution of costs that reflects the level of effort or benefit received by the various cost objectives.